Chickasaw Capital Management

Weekly Midstream & Market Pulse

MAY 17, 2020

With Q1:2020 earnings now complete we felt it would be helpful to recap what was reported and any "learnings from earnings".

Earnings & Sentiment Recap

Midstream companies generally reported upbeat quarterly results. Importantly, Midstream management teams struck an appropriate balance between demonstrating the resiliency of their business models and acknowledging the unknowns associated with additional negative ramifications from COVID-19.

Macro commentary remained very fluid and real-time beginning on April 21st with Kinder Morgan Inc (KMI, $14.84) through May 11th with Energy Transfer LP (ET, $7.20). The outlook for demand and supply was initially more conservative as the U.S. was still near total lockdown. By the end of the reporting season, there was discussion from ET, Targa Resources Corp (TRGP, $15.03) and others that oil and natural gas liquids (NGL) production — the area of most concern — had bottomed in late April and was already seeing green shoots of resumption in certain areas, notably the Permian Basin. Additionally, KMI, Magellan Midstream Partners, LP (MMP, $41.84), Shell Midstream Partners LP (SHLX, $13.08), and BP Midstream Partners LP (BPMP, $11.52) indicated on earnings calls and bank-hosted meetings that gasoline demand in May had been stronger than the April exit rate.

Similar to other sectors of the economy, Midstream companies, which give guidance as part of their financial communication, either provided a broader range of guidance too allow for macro economic uncertainty, or withdrew certain aspects of their guidance such as expectations for distribution growth, or certain operational measures. Looking across the space as a whole, the updated financial guidance for cash flow, typically represented by earnings before interest, taxes, depreciation and amortization (EBITDA), was favorable to our internal forecasts, which we've laid out previously, nor did it cause large revisions from consensus expectations, as discussed below. An additional point is that we and others had been modeling a more conservative financial expectation to take place for 3 to 4 quarters beginning in Q2:2020. However, company commentary indicated Q2 has the potential to be the trough quarter based on May versus April demand and supply responses, and then, if so, quarterly improvement would begin Q3:2020.

Companies also moved swiftly to protect their balance sheets in an uncertain environment by pulling different corporate levers, which include: reducing growth capital expenditures; reducing operating and selling, general and administrative (SG&A) expenses; and, for certain companies, reducing dividends and distributions. Leverage and liquidity measures generally met our expectations as well.

INVESTMENT TEAM

Geoffrey P. Mavar – Principal
Matthew G. Mead – Principal
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Distributable Cash Flow or DCF is calculated as net income plus depreciation and other noncash items, less maintenance capital expenditure requirements. Distributable Cash Flow (DCF) data is CCM-calculated consensus of Wall Street estimates. DCF/u growth is not a forecast of the portfolio's future performance. DCF growth rate for the portfolio's holdings does not guarantee a corresponding increase in the market value of the holding or the portfolio.

Distributions are quarterly payments, similar to dividends, made to Limited Partner (LP) and General Partner (GP) investors. These amounts are set by the GP and are supported by an MLP's operating cash flows.

Growth Capital Expenditures or Growth CapEx or GCX refers to the aggregate of all capital expenditures undertaken to further growth prospects and/or expand operations and excludes any maintenance and regulatory capital expenditures.

By The Numbers

During the quarter, our Model Portfolio reflected the following cash flow statistics:

- EBITDA beat consensus expectations by +4.7% on average.
  - Weighted average 2020 EBITDA guidance for the 15 names in the Model Portfolio that provide guidance decreased (4.2%) on average relative to the prior reporting season.
  - EBITDA guidance for 2020 decreased (1.0%) on average relative to consensus estimates prior to the earnings calls.
- Average distributable cash flow per unit (DCF/u) beat consensus by +8.4% on average.
  - Year-over-year (YOY), weighted average DCF/u was down slightly at (0.8)% consistent with our expectations.

To offer a comparison, Midstream companies that are not currently owned in the Model Portfolio reflected the following cash flow statistics:

- EBITDA beat consensus expectations by +4.0% on average.
- Average distributable cash flow per unit (DCF/u) beat consensus by +10.5% on average.
  - Year-over-year (YOY), weighted average DCF/u was down slightly at (1.9%).

In an effort to sustain and strengthen their balance sheets, companies within the Model Portfolio reported:

- Aggregate growth capital expenditures decreased (16.5%) to $29.9 billion (from $33.5 billion) with the intention to continue to reduce or push out costs.
- Aggregate discretionary maintenance capital expenditures decreased (10.7%) to $4.2 billion (from $4.7 billion).
- Thirteen of 20 companies reported progress on reducing expenses by $4.1 billion in aggregate, or a (5.9%) decrease (from a $47 billion prior base).
  - We believe companies have the ability to exceed this guidance, particularly with capital allocation efficiency measures.
- Distribution and dividends declared were down (12.8%) on a weighted average basis.
  - For Midstream companies not owned, distributions and dividends were down (11.1%) on average.

Notable and Quotable

Jim Teague, CEO, Enterprise Products Partners, LP (EPD, $17.17), April 29, 2020

“Some of our businesses are steady as a rock. Our NGL fractionators are full and will remain so. And our NGL pipelines, overall, haven’t seen a downturn. Our Permian crude oil pipelines are fully contracted, and Seaway is virtually full. Our petrochemical business is challenged as motor gasoline demand has fallen and refinery runs have been cut. Once refinery runs improve, so will our petrochemicals. Natural gas throughput on our Texas and Louisiana intrastate pipelines have been full. While our natural gas processing has suffered, this is a business that I believe has potential upside in the second half of the year. Opportunities around our assets are abundant.”

Michael Mears, CEO, Magellan Midstream Partners, LP (MMP, $41.84), May 1, 2020

"Our gasoline loadings were down 33% for the month of April. Our distillate loadings were down 9% and our jet deliveries, which is a much smaller portion of our movements was down 72%. If I look at just the last 7 days of April, those numbers have improved substantially. Gasoline for the last 7 days of April is down 24% year-over-year. Distillate is down 4% and jet is down 76%."

Alan Armstong, CEO, Williams Cos Inc (WMB, $18.76), May, 5, 2020

"Overall, we're seeing natural gas demand has remained strong, both broadly across the market and on our systems. In fact, we're seeing evidence that natural gas is not only holding up nicely, but even exceeding recent historical norms...Demand in the continental U.S. has generally been above the three-year historical average in comparable weeks for natural gas. We have strong demand in the power sector. Industrial is down slightly, [residential/commercial] has held in very well despite mild weather. And LNG and Mexico exports have driven demand up over the prior year averages."

Jennifer Kneale, CFO, Targa Resources Corp (TRGP, $15.03), May 7, 2020

"...[G]iven the uncertainties in this environment we are updating our full year 2020 adjusted EBITDA estimate to $1.4 billion to $1.625 billion and withdrawing our previously disclosed full year 2020 operational expectations. We would like to share what we see as a reasonable range of expected outcomes and some color around detailed downside cases that we ran internally. For example, we ran a downside case, which assumed 30% production shut-ins for the remainder of the year in the Permian Basin and in that scenario, we believe we would generate somewhere around $1.4 billion of full-year 2020 adjusted EBITDA. Based on recent producer dialog, we currently don't expect that negative production case to occur but rather some lesser amount of volume shut-ins for a duration of a couple to several months. So we believe an expectation of full-year 2020 adjusted EBITDA of around $1.4 billion to $1.625 billion depending on production levels covers a reasonable range of potential outcomes."

Mackie McCrea, COO, Energy Transfer LP (ET, $7.20), May 11, 2020

"...[T]hings really got difficult kind of last part of April and then in May. However, how it's impacting our assets in a couple of ways is, for example, in our G&P assets we have had some volumes shut-in. However, just to give an example in the Midland Basin, we've had about 8% of the volume shut-in—that was the beginning of May—and as of today we've seen about 25% of that turned back on."

Geoffrey Mavar Matt Mead Robert Walker Bryan Bulawa